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Department of the Treasury
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 , ID No.

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Refer Reply To:
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Date:
July 27, 2006

Legend

Parent =

Distributing =

Sub 1 =

Sub 2 =

Controlled =

State A =

State B =

Shareholder A =

X% =

Y% =

Z% =

Business A =

Business B =

Date 1 =

Date 2 =

Date 3 =

Dear

This ruling is in reply to your representative's letter dated May 3, 2006 for rulings concerning the Federal income tax consequences of a completed transaction. Additional information was submitted in a letter dated June 13, 2006. The material information submitted for consideration is substantially as set forth below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations and other data may be required as part of the audit process.

Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the transaction, as completed: (i) satisfies the business purpose requirement of section 1.355-2(b) of the Income Tax Regulations, (ii) is used principally as a device for the distribution of the earnings and profits of the distributing corporation, the controlled corporation or both (see section 355(a)(1)(B) of the Internal Revenue Code and Treas. Reg. section 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation (see section 355(e)(2)(A)(ii) and Treas. Reg. section 1.355-7).

Summary of Facts

Parent is a State A corporation and the common parent of an affiliated group of corporations filing a consolidated return on a calendar-year basis. Parent owns all of the stock of Sub 1, which owns all of the outstanding stock of Sub 2. Parent also owns X% of Distributing's sole outstanding class of common stock, a State B corporation. Shareholder A and two other shareholders owned the remaining Y% and Z%, respectively, of Distributing's common stock. Distributing was engaged in Business A and Business B.

Distributing has submitted financial information indicating that Distributing has gross receipts and operating expenses that serves to represent that Business A and Business B were each actively conducted in each of the past five years.

Transaction

For what has been represented as a valid business purpose, the taxpayer consummated the following transactions:

- (i) On Date 1, Distributing contributed all of the assets relating to Business B to a newly formed State B corporation, Controlled, in exchange for all of the outstanding common stock of Controlled and the assumption by Controlled of related liabilities (the "Contribution").
- (ii) On Date 1, Distributing redeemed the Distributing shares held by its two minority shareholders other than Shareholder A for cash.
- (iii) On Date 1, Distributing distributed all of the shares of Controlled non pro rata to Shareholder A in exchange for all of Shareholder A's stock in Distributing (the "Distribution").
- (iv) On Date 1, Parent contributed the stock of Distributing to Sub 1, which contributed the stock of Distributing to Sub 2.
- (v) On Date 2, Distributing converted into State B limited liability company that will be disregarded as an entity separate from its owner for Federal income tax purposes.

Representations

The following representations are made with respect to the Contribution and the Distribution:

- (a) The indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (b) The fair market value of the Controlled stock and other consideration received by each shareholder of Distributing was approximately equal to the fair market value of the Distributing stock surrendered by the shareholder in the exchange.
- (c) No part of the consideration to be distributed by Distributing was received by a shareholder as a creditor, employee, or in any capacity other than as that of a shareholder of the corporation.
- (d) The five years of financial information submitted on behalf of Business A is representative of the business's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) The five years of financial information submitted on behalf of the Business B is representative of the business's present operation, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (f) Following the Distribution, Distributing and Controlled each will continue the active conduct of its business, independently and with its separate employees.
- (g) The distribution of the stock of Controlled was carried out for one or more of the following corporate business purposes: (1) to improve the fit and focus of Business B, and (2) to achieve cost savings for Distributing by facilitating the tax-free merger of Distributing with an affiliated corporation. The distribution of the stock of Controlled was motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (h) The Distribution was not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled, or both. See section 355(a)(1)(B).
- (i) The total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing in the Contribution each equaled or exceeded (i) the sum of the liabilities assumed (as determined under section 357(d)) by Controlled, and (ii) the total amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing from Controlled and transferred to Distributing's creditors in connection with the exchange.
- (j) The liabilities assumed (as determined under section 357(d)) by Controlled in the Transaction were incurred in the ordinary course of business and are associated with the assets transferred.

- (k) The total fair market value of the assets transferred to Controlled in the Contribution exceeded the sum of (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under section 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The total fair market value of the assets of Controlled exceeded the total amount of its liabilities immediately after the exchange.
- (l) The aggregate fair market value of the assets contributed to Controlled in the Contribution exceeded the aggregate basis of those assets.
- (m) Distributing neither accumulated its receivables nor made extraordinary payments of its payables in anticipation of the Distribution.
- (n) Other than the potential obligation of Controlled to reimburse Distributing for employee severance payments on or before Date 3, and liabilities with respect to tax indemnity agreements to be entered into by the parties, no intercorporate debt existed between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled's stock, other than liabilities incurred in the ordinary course of business.
- (o) Immediately before the Distribution, items of income, gain, loss, deduction, and credit will be taken into account as required by the applicable intercompany transaction regulations (see Treas. Reg. sections 1.1502-13 and 1.1502-14 as in effect before the publication of T.D. 8597, 1995-32 I.R.B. 6, and as currently in effect, Treas. Reg. section 1.1502-13 as published by T.D. 8597). Further, any excess loss account that Distributing had in the Controlled stock will be included in income immediately before the Distribution to the extent required by regulations (see Treas. Reg. section 1.1502-19).
- (p) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (q) Neither Distributing nor Controlled is an investment company as defined in section 368(a)(2)(F)(iii) and (iv).
- (r) Distributing, Controlled, and the Distributing shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
- (s) For purposes of section 355(d), immediately after the distribution, no person (determined after applying section 355(d)(7)) holds stock possessing 50 percent or

more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

(t) For purposes of section 355(d), immediately after the distribution, no person (determined after applying section 355(d)(7)) holds stock possessing 50 percent or more of the total combined voting power or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.

(u) The Distribution was not part of a plan or series of related transactions (within the meaning of Treas. Reg. section 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

Rulings

Based solely on the information submitted, and on the representations set forth above, this Office rules as follows:

(1) The transfer by Distributing of the assets of Business B to Controlled solely in exchange for common stock of Controlled and the assumption of related liabilities, followed by the distribution by Distributing of all the Controlled stock non pro rata to one of its shareholders, will constitute a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be “a party to a reorganization” within the meaning of section 368(b).

(2) No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for common stock of Controlled and the assumption of related liabilities (sections 361(a) and 357(a) and (c)).

(3) No gain or loss will be recognized by Controlled upon the receipt of the assets from Distributing in exchange for common stock of Controlled and the assumption of related liabilities (section 1032(a)).

(4) The basis of the assets to be received by Controlled will be the same as the basis of such assets in the hands of Distributing (section 362(b)).

- (5) The holding period of the Distributing assets to be received by Controlled will include the period during which such assets were held by Distributing (section 1223(2)).
- (6) No gain or loss will be recognized by Distributing upon the distribution of all of the stock of Controlled (section 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) any Distributing shareholder upon the receipt of the stock of Controlled (section 355(a)(1)).
- (8) Shareholder A's basis in a share of his Distributing stock (as adjusted under § 1.358-1) that is exchanged for the Controlled stock shall be allocated to the Controlled stock. If one share of Controlled stock is received in exchange for more than one share of Distributing stock, the basis of each share of Distributing stock must be allocated to the Controlled stock in a manner that reflects that, to the greatest extent possible, a share of Controlled stock received is received in exchange for shares of Distributing stock acquired on the same date and at the same price. If Shareholder A purchased or acquired shares of Distributing stock on different dates or at different prices is not able to identify which particular share of Controlled stock is received in exchange for a particular share of Distributing stock, Shareholder A may designate which share of Controlled stock is received with respect to a particular share of Distributing stock, provided the terms of the designation are consistent with the terms of the Distribution.
- (9) The holding period of the stock of Controlled to be received by the shareholder will include the holding period during which the shareholder held the Distributing stock on which the Distribution is made, provided that the shares of Distributing stock were held as a capital asset on the date of the Distribution (section 1223(1)).
- (10) Earnings and profits will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. section 1.312-10(a).

No opinion is expressed about the tax treatment of the transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of Treas. Reg. section 1.355-2(b); (ii) whether the transaction is used principally as a device for the distribution of the earnings and profits of either the Distributing or Controlled or both (see section 355(a)(1)(B) and Treas. Reg. section 1.355-2(d)); and (iii) whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii).

No opinion is expressed with respect to the tax consequences of steps (iv) and (v) in the Transaction whereby in (iv) Parent contributed the stock of Distributing to Sub 1, which

contributed the stock of Distributing to Sub 2 as well as in (v), whereby Distributing converted into a State B limited liability company that will be disregarded as an entity separate from its owner for Federal income tax purposes.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Steven J. Hankin
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel (Corporate)